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Surviving beyond a third generation

Family-owned businesses' continued survival is unsure. Research indicates the most likely cause is their pursuit of professionalisation.

By Andreas Raharso

Family-owned businesses (FOBs) are the backbone of the economic systems in most countries. A 2012 Ernst and Young report disclosed that family businesses make up more than 60 percent of all companies in Europe and the Americas, and account for about 50 percent of total employment. In Asia, the situation is similar. According to a 2012 report by Credit Suisse across 10 Asian markets, more than 70 percent of Asian firms are family-owned, accounting for nearly half of all listed companies and 32 percent of total market capitalisation. These businesses also employ 57 percent and 32 percent of all listed companies' employees in South Asia and North Asia respectively. Thus, their role in the Asian economy is of tremendous importance.

However, their continued survival is uncertain. The global, multidisciplinary professional association for family enterprise, Family Firm Institute, reports that around 70 percent of FOBs will not survive into the second generation, and 90 percent will not make it to the third generation. The

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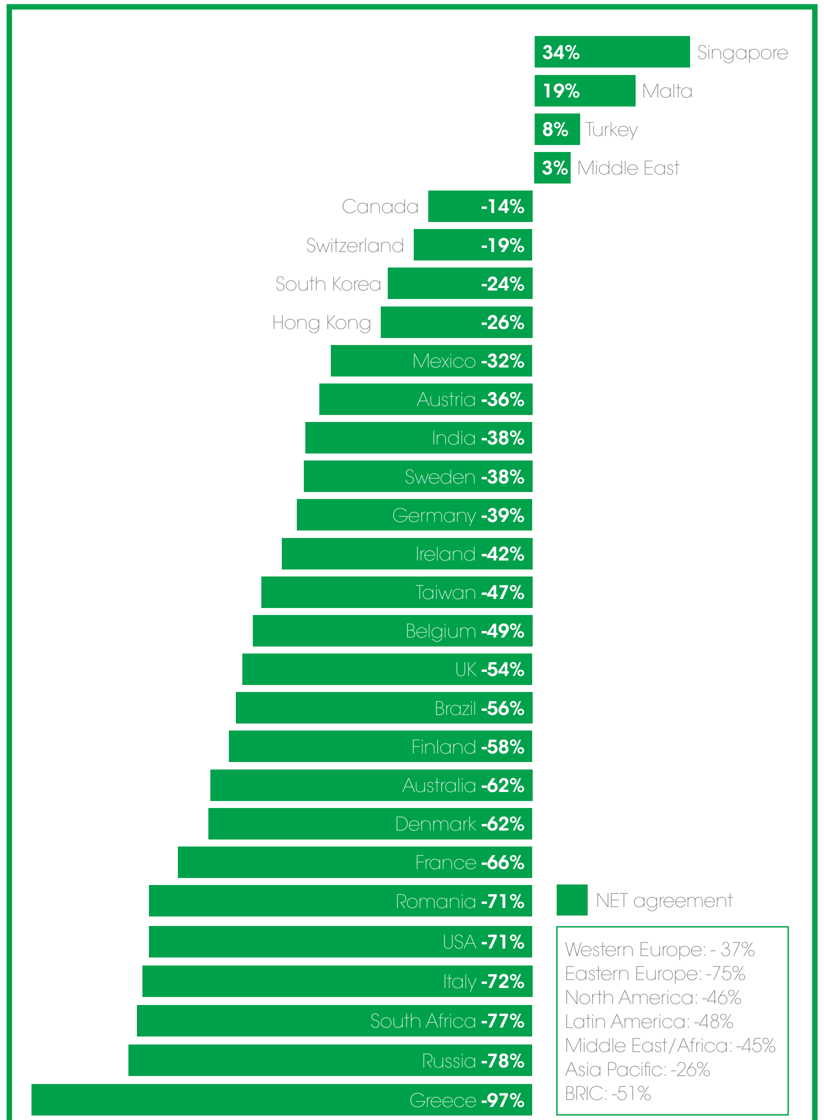
question is why? Hay Group research indicates that FOBs view the lack of government support as the major factor threatening their survivability, whereas in reality the most likely cause is their pursuit of professionalisation. Professionalisation can often lead to the deterioration of family relationships if it is not set firmly within a basis of mature family capital. Thus those that focus on developing rich family capital are better prepared for the risks associated with professionalisation.

Over-reliance on government support

Many of today's top Asian FOBs have had significant support from their government, a fact best illustrated by South Korea's FOBs or *chaebols* that emerged in the 1950s and marked the rise of protectionism. The chaebols were then some of the world's largest FOBs and appeared after the departure of the Japanese in 1945 when the newly formed government entrusted a handful of Korean businessmen with the assets of several Japanese firms. Fast-forward to the 1990s and several had grown into household names, such as Samsung, Hyundai and LG. Similarly, many Asian countries adopted protectionist policies to develop their domestic industries while defending themselves from foreign competition.

However, rapid globalisation over the last few decades has changed the business climate drastically. This is even more apparent in countries like China, where post-1998 economic reform have relaxed protectionist policies. It is therefore not surprising that a PwC 2012 report on global family business indicates that approximately 26 percent of FOBs in the Asia-Pacific region feel negatively about the government's role in helping them survive in the current business climate.

FAMILY FIRMS AND PERCEPTIONS OF THE GOVERNMENT'S ROLE IN THE CURRENT CLIMATE



* NET agreement = proportion of those agreeing and subtracting the porportion of those disagreeing

Source: PwC Family Business Survey 2012

According to a report by the Conway Centre for Family Business, the life span of family firms has reduced significantly over the past few decades. In the 1990s, firms would typically last 50 to 60 years (equivalent to two to three generations) compared to their current average span of about 24 years (about one-and-a-half generations). We therefore ask to what extent is the shortened life span a result of the lack of government support?

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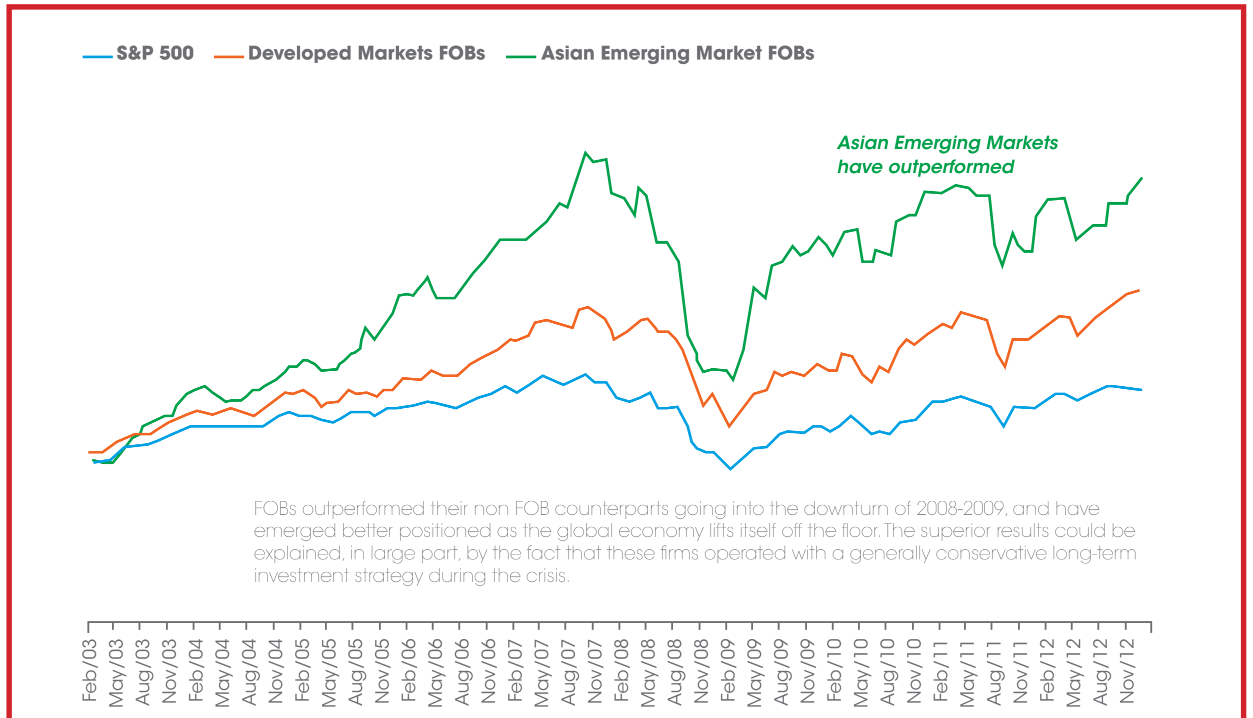
Our analysis shows that their performance is not as heavily dependent on government protectionist policies as they think it is. This view is substantiated by their performance during the financial crisis. During an economic downturn, most governments struggle to find the perfect mix of interventionist policies, and are thus unlikely to give preferential treatment to particular industries. However, notwithstanding the Asian and global financial crises in 1998 and 2008, FOBs all over the world, including Asian ones, outperformed their non-family controlled counterparts in the period 2003-2012.

RELATIVE PERFORMANCE OF FOBS VERSUS S&P 500



FOBs outperformed their non FOB counterparts going into the downturn of 2008-2009, and have emerged better positioned as the global economy lifts itself off the floor. The superior results could be explained, in large part, by the fact that these firms operated with a generally conservative long-term investment strategy during the crisis.

Sources: Bloomberg and Hay Group Economic Analysis

Professionalising the FOB: A lethal threat

Hay Group research believes that the greatest threat to a FOB's life span is not the lack of government support, but the pursuit of professionalising the business. This requires the company to clearly distinguish family and business interests, and entails them tapping into essential external resources, such as recruiting and retaining talented non-family employees. In reality, professionalising can be both a blessing and a curse–it can provide family enterprises with the necessary tools for business evolution, but may also see less priority placed on those family relationships that supported the business during its early days.

Pursuing professionalisation should see them being able to tap into the strength of the family capital – and by not doing so, problems can be accentuated, as most of their attention is diverted to efforts to achieve professionalisation rather than resolving the problems.

FOBs face many unique challenges that need to be resolved using the strength of family ties and relationships. Pursuing professionalisation should see them being able to tap into the strength of the family capital–and by not doing so, problems can be accentuated, as most of their attention is diverted to efforts to achieve professionalisation rather than resolving the problems.

Moreover, mismanaged professionalisation attempts can make matters worse. Many FOBs are faced with an inherent conflict that typically arises from their inability to separate business and personal affairs. Sometimes the feuding is due to the varying interests of each family member, or a combination of personal egos and rivalries that spill into the business environment.

Keeping it in the family is one thing, but forcefully involving family members who do not fit the needs of the business is another. There are numerous occasions in which FOBs have family members on their payroll holding top-level positions, not because of the expertise they lend or the merits of their professional experience, but by virtue of them being related to another family member. This form of special treatment ends up dividing employees by creating different classes among them. It can also be a great demotivating factor for non-family member employees. One of the biggest criticisms of growing family-owned businesses is that they do not provide opportunities for non-family members to advance into leadership positions. Without the opportunity to advance or take on a leadership role, many talented and ambitious employees will move on to better opportunities outside. FOBs need to recognise that their employees should not be discriminated against based on their ties to the family, as they cannot survive without talented employees who represent the lifeblood of the business.

The biggest challenge that remains is succession planning.

The biggest challenge that remains is succession planning. Although not a difficult decision for a non-family business, it can be a daunting task for FOBs, which have two objectives that are of equal weighting; one, to ensure sustainability of the business, and second, to ensure the family has a controlling interest in the business. It is the latter that gives rise to the difficulties in succession planning. In an interview with the *Financial Times*, Yupana Wiwattanakantang, associate professor of finance and corporate governance at the National University of Singapore Business School shared that the reason succession planning is difficult for Asian FOBs is because leaders of family businesses in Asia tend to be patriarchs rather than matriarchs, and these men want to continue to remain at the helm of the organisation until their dying day. This mentality prevents them from training or selecting a proper successor, resulting in a void that cannot be filled when the need arises. FOBs thus need to have a clear succession plan, or they are setting their business up for failure.

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THE AMBANIS' POWER OF WILL

The famous Ambani brothers' feud is well-known throughout Asia. However, what was most alarming is the lack of succession planning by their father Dhirubhai Ambani that led to the situation. In July 2002, the founder of Reliance Industries in India passed away without leaving behind a will or a formal succession plan for his empire. Since then, the brothers have been involved in a series of constant struggles for power that eventually led to the demerger of the company, brokered by their mother in 2005. These struggles gave Mukesh Ambani control of oil and gas, petrochemicals, refining and manufacturing while the younger brother, Anil Ambani took control of electricity, telecommunications and financial services.

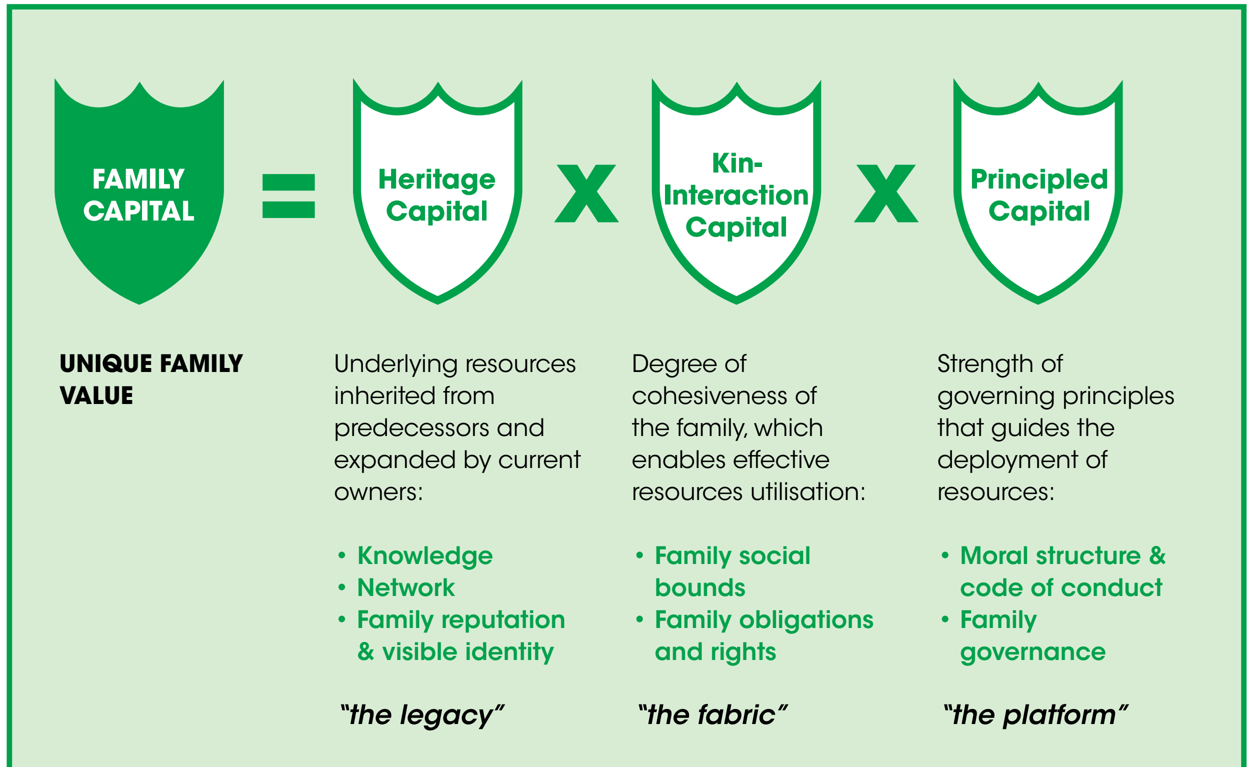
Business Insider: The Full Story Of The Massive Feud Between The Billionaire Ambani Brothers (http://www.businessinsider.com/ambani-brothers-feud-reliance-2011-05?op=1#ixzz2Vte2tuw5)

Prescribing *Family Capital* as a cure

An extensive global survey in 2012 of 160 family businesses (including 35 Asian firms) allowed the Hay Group to identify the critical key strength that can make the transition to successful professionalisation smoother – and the answer was high levels of "family capital", which enables FOBs to respond more positively to the continuation of their business into the next generation. Three key components of family capital were uncovered: heritage, kin-interaction and principled capital, each of which can be developed individually to create a multiplier effect that increases the overall family capital to support the business.

Heritage capital is the legacy inherited from previous generations. The implications for heritage are important to survival. It plays a guiding and stabilising role in allowing family-owned businesses to promote their uniqueness and competitive strengths to external stakeholders. The next generation of family members is able to tap into the wealth of knowledge and networks created by their forefathers, ensuring that corporate values are interwoven into the family heritage. Family members thus do not suffer any disconnect between business objectives and family legacy.

COMPONENTS OF FAMILY CAPITAL

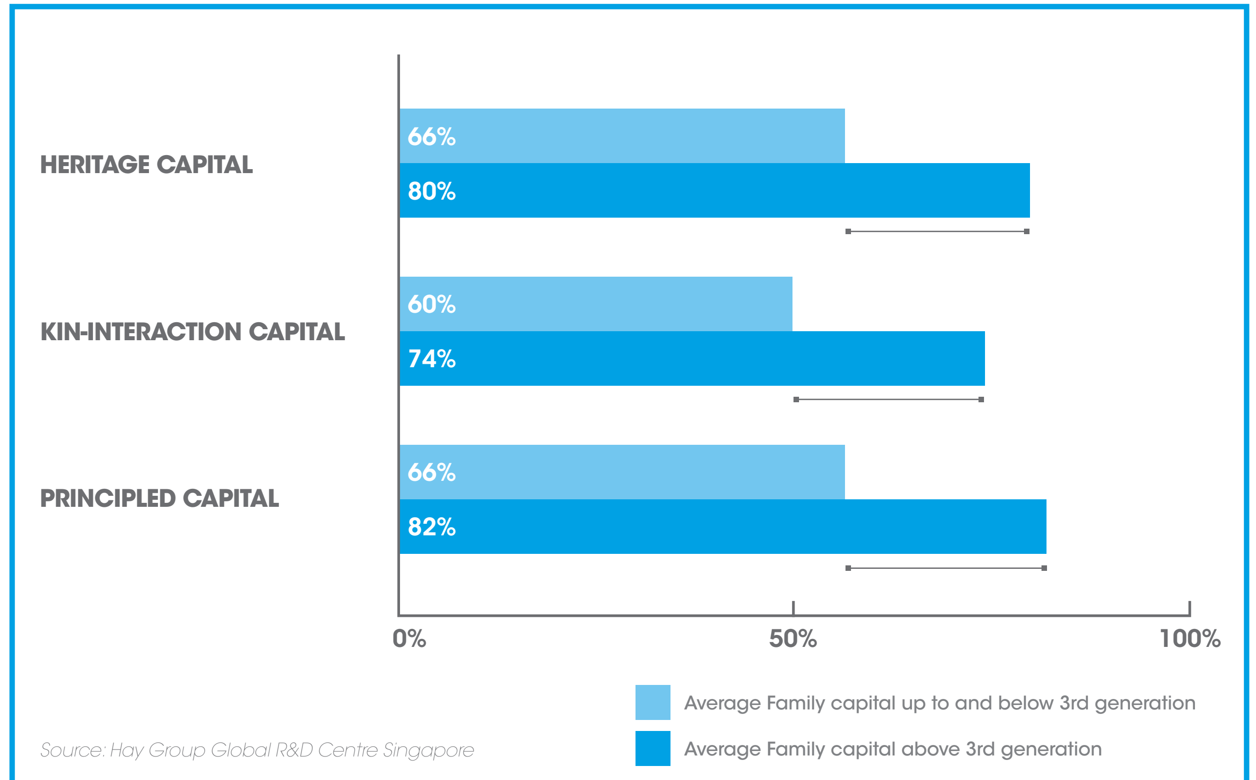


Source: Hay Group Global R&D Centre Singapore

Preserving and enhancing quality kin-interaction within FOBs by focusing on the family member's rights and obligations is the second component that can enhance family capital. Though commonly confused with one another, rights and obligations possess distinct differences. Rights refer to the privileges that family members enjoy in making decisions regarding the family business. These privileges should not displace or override obligations that family members have towards their family and the business. Too many family-owned businesses disappear as a consequence of not paying attention to the quality of the bonds that hold the family together, and connect it to their enterprise. In such a context, detached or uncommitted family members exploit to exhaustion the assets they have received, until little is left for the following generation.

Finally, family moral infrastructure and governance policies are of instrumental importance in preparing future generations to run the family business. This is something that external employees will not be able to bring to the company, and has to be a practice that is passed on within the family. This authenticity is the essence of principled capital. Equipping the next generation with the tools of the trade is not a simple task. One step that older generations can take is to create a strong civic structure encouraging younger members to act in a manner that is consistent with the workplace while incorporating family values. This can be done by actively governing the way family members interact with the business, ensuring that its conduct is compliant with the law while being in line with the family vision for the business.

FOBS IN THE HIGHER GENERATION (>3RD GEN) CONSISTENTLY HAVE HIGHER LEVELS OF FAMILY CAPITAL COMPONENTS THAN FOBS IN THE LOWER GENERATION (3RD GEN AND BELOW).



Source: Hay Group Global R&D Centre Singapore

Putting together the sum of the parts

Combining the three integral variables allows FOBs to maintain long-term financial and social stability. They are able to attain sustained growth through identifying the unique resources and networks created by their forefathers (heritage), fully utilising and developing those resources (kin-interaction) and guiding their optimal use (principled capital). Lessons from those FOBs that have made the leap beyond the third generation prove that family capital can help them be better prepared for family feuds as well as utilise formal structures to create a succession plan. Feuds are most likely to occur during the attempt to professionalise. Our analysis has also identified that FOBs who survive beyond the third generation have higher levels of family capital when compared to those who do not survive as long. For this reason, it is important to have a sound mix of guiding principles, rights and obligations, and moral infrastructure.

FOBs are unique because their objectives are two-fold: sustaining the business and keeping the family together as a cohesive unit. For many years, FOBs have operated with the idea that a trade-off between the objectives becomes essential after the third generation. However, as we have argued in this article, these objectives can support each other if FOBs learn to manage the balance of their family capital and professionalisation of the business. Yet the trick is to be able to develop the family capital as a foundation for professionalisation. Developing family capital before professionalisation, or the lack of either one, will result in the demise of the FOB.

Developing family capital before professionalisation, or the lack of either one, will result in the demise of the FOB.

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